CHARTA LEARNING · LESSON NOTES

Standard V: investment analysis, recommendations and actions

CFA Level I · Ethical and Professional Standards

You will learn: State what Standard V asks of an analyst: do the work (V(A) Diligence and Reasonable Basis), tell the client what matters (V(B) Communication with Clients) and keep the proof (V(C) Record Retention), and judge short cases for each.

Running example: Examples use made-up people and a made-up firm, Larkspur Advisers, with made-up figures.

1. V(A) Diligence and Reasonable Basis

- Members must exercise diligence, independence and thoroughness when they analyse investments, make recommendations and take investment actions, and must have a reasonable and adequate basis supported by appropriate research and investigation.
- Diligence: careful, committed effort. Independence: your own view, not borrowed or bent by pressure. Thoroughness: cover the factors that matter. Reasonable basis: good reasons you could explain. Test: could you show today why you were entitled to believe the recommendation?
- How much work is enough rises with what rests on the analysis, the share of the portfolio at stake. Same standard, different depth.
- Doing it yourself: gather facts, test assumptions, weigh risks, record a view. Relying on a broker report or quantitative model is allowed after reasonable effort to check how it was built, performed, and its assumptions and limits. A famous name or clever model is never the check.

2. V(A) in cases

- Case 1: Maya copies a famous broker's buy report and target price without checking method or figures. Violation: reputation is not a substitute for reasonable effort, and being right by luck does not save her.
- Case 2: Dev recommends the top five names from a screening model but cannot say what it assumes or when it fails. Violation: relying on a model requires understanding its assumptions and limitations, not only its output.
- Case 4: Rosa disagrees with a committee rating whose basis is sound (audited accounts, tested forecast, clear assumptions). No violation; she need not dissociate. If she believed the basis was not reasonable, she should ask for her name to be removed.
- Choosing an outside manager or adviser needs the same diligence: look at their process, record and risks, not a brochure.

CASE 3: LENA'S $2,000,000 PORTFOLIO

Trade A: $40,000	40,000 ÷ 2,000,000	**2%: quick check is fine**
Trade B: $600,000	600,000 ÷ 2,000,000	**30%: needs far deeper research**
Same quick check on trade B	stakes large, work too thin	**Violation**

3. V(B) Communication with Clients

- Members must disclose to clients and prospective clients the nature of the services and information about their costs (added in the twelfth edition). Include costs through affiliates or third parties. Exact amounts are not needed if unknowable in advance. A sophisticated client is no reason to omit costs.
- A client is owed, in order: the services and their costs; the basic format and general principles of the investment process, and prompt disclosure of any material change to it; the significant limitations and risks of this advice; a clear line between fact and opinion.
- Fact runs to opinion: reported sales, a calculated margin, next year's estimate, a two-year price forecast, a belief such as will dominate. Do not avoid opinions: label them.
- A summary is allowed: the test is not length but whether a factor material to the conclusion is left out. A general disclaimer does not cure an omitted known risk. Material means a reasonable client would think differently if they knew.

CASE 5: SAMIR ADVISES MR REED (ASSETS $500,000)

Advisory fee told	500,000 × 1.00%	**$5,000**
Affiliate fund fee, not told	500,000 × 0.30%	**$1,500**
True yearly cost	5,000 + 1,500	**$6,500 = 1.3%**
Verdict	affiliate costs must be disclosed	**V(B) violation**

4. V(B) in cases: strategy change, hidden risk, good summary

- Case 6: Larkspur told clients for years it chose cheap, steady value companies, then began buying momentum shares and wrote nothing to clients. Violation: disclose any material change to the process promptly, before or when it takes effect.
- Case 8: Omar sends a one page summary of a 40 page report with the conclusion, the three drivers, the two biggest risks, forecasts labelled as his estimate and facts as fact, and says the full report is available. No violation: short and complete beats long and padded.

CASE 7: NINA OMITS A KNOWN RISK IN A SMALL MANUFACTURER'S REPORT (SALES $80M)

Biggest customer's sales	48 ÷ 80	**60%**
Contract under review	known to Nina, omitted	**boilerplate disclaimer not enough**
Verdict	significant known risk left out	**V(B) violation**

5. V(C) Record Retention

- Members must develop and maintain appropriate records to support their investment analyses, recommendations, actions and other communications with clients and prospective clients. Purpose: evidence that a reasonable basis existed at the time. Paper or electronic, including business messages, kept in the firm's own systems.
- Records are the firm's property. A departing member may not take them without the employer's consent. At the new firm, recreate the support from public sources, then rely on the earlier conclusion. Memory is not a record.
- Retention: follow local rules first; where none sets a period, the CFA Institute recommends at least seven years. If local law requires longer, follow it. Never use a shorter period because it is convenient.
- One test for any case, in order: enough work (V(A))? Client told (V(B))? Proof kept (V(C))? Many cases fail more than one.

CASE 10: RECOMMENDATION DATED 15 MARCH 2027

No local rule: 7 years	2027 + 7	**15 Mar 2034**
Local law says 10 years	2027 + 10	**15 Mar 2037**

Watch out: Case 9: Tessa copies valuation spreadsheets and notes to a personal drive on leaving: violation of V(C), and probably of loyalty. Case 11: Hana rebuilds her support from public filings at the new firm before publishing: no violation.

Key takeaways

- Scale the work to the stakes: a 2% trade and a 30% core holding need different depth.
- Reputation and models are starting points, never the check.
- Disclose services and their costs, including through affiliates, plus process, material changes, significant risks, and fact versus opinion.
- A summary is fine, but a material omission is not, and a disclaimer does not cure it.
- Records belong to the firm: take nothing, rebuild from public sources after a move.
- Keep records as local rules require, else at least seven years. These standards judge the process, not the outcome.

Quick check

1. Analyst copies a famous broker's target unchecked. OK?
   Answer: No: reputation alone is not enough; it breaches V(A).
2. Known big risk left out; generic disclaimer on last page. OK?
   Answer: No: a disclaimer does not cure leaving out a significant known risk; V(B) is breached.
3. New firm: analyst rebuilds support from public sources. OK?
   Answer: Yes: the old records belong to the former firm, and recreating support is what V(C) expects.